

CONFIDENTIAL

## Current Support Brief

AKTIVNOST' VERSUS PROFIT MAXIMIZATION:  
A CONFLICT IN ECONOMIC PHILOSOPHY IN THE USSR



CIA/RR CB 63-8

16 January 1963

CENTRAL INTELLIGENCE AGENCY

Office of Research and Reports

CONFIDENTIAL



**W A R N I N G**

This material contains information affecting the National Defense of the United States within the meaning of the espionage laws, Title 18, USC, Secs. 793 and 794, the transmission or revelation of which in any manner to an unauthorized person is prohibited by law.

C-O-N-F-I-D-E-N-T-I-A-L

AKTIVNOST' VERSUS PROFIT MAXIMIZATION\*:  
A CONFLICT IN ECONOMIC PHILOSOPHY IN THE USSR

I. Introduction

Among the many speculations current about the future evolution of the Soviet economy is the suggestion that the Soviet leaders may increasingly adopt capitalist techniques in order to improve economic efficiency. In the last few months, as if in confirmation of this suggestion, some Soviet economists have proposed that profitability be the aim and the success indicator of enterprise management. They also have proposed that prices be more explicitly recognized as influential in enterprise decision making and be reformed accordingly. The proposals are very reminiscent of "market socialism," the version of socialism which most resembles capitalism and which is practiced, imperfectly, in Yugoslavia.

Khrushchev has gone to some pains to build a reputation for liberalism (definition optional with the reader). His often-repeated organizational preferences include an implacable opposition to bureaucratic rigidities, emphasis on the creative initiative of workers and production managers, a continuing demand for efficient use of resources, and an unashamed admiration for the beneficial effect of competition on the productivity of the individual farm and firm in the US. It is tempting to assume that some modification of "market socialism" would be consistent with these preferences. Indeed the Soviet economists appear to be making just this assumption.

The purpose of this publication is to argue that the assumption is wrong. Khrushchev's approach to economic management is basically incompatible with the proposals of the economists. This is not to argue that the economists' proposals may not be adopted but that, even if they are adopted, they will not work as intended.

\* The term Aktivnost' is used here to mean Communist Party activism.

C-O-N-F-I-D-E-N-T-I-A-L

C-O-N-F-I-D-E-N-T-I-A-L

## II. The "Manchester" Communists

The demands for more decentralized economic arrangements come from a small group of Soviet economists and from some, if not all, enterprise managers. The recent proposals of these economists and enterprise managers represent the convergence of two streams of thought which closely resemble the two basic ideas of market socialism as expounded by Oskar Lange.\* These two ideas are that the socialist state should (1) set market (or transfer) prices which equate supply and demand and (2) enjoin production managers to seek maximum profit (at the prices set under 1), but otherwise not interfere in enterprise management.

The first stream of thought was set in motion in 1959 by the Leningrad mathematical economist, Kantorovich. Kantorovich was one of the original inventors of linear programming, a generalized mathematical method for solving problems of choice (for an optimum result) under complicated technical restraints.\*\* In 1959 he published a book which applied linear programming to the problem of general economic planning. One feature of his proposal that attracted widespread interest among economists was that the calculations called for could be programmed on electronic computers. The notion that central planning could be carried out by electronic computer was immediately caught up by a large number (but not all) of Soviet economists. Many special institutes for the development of mathematical techniques of planning were established, and research is being actively pushed.

The other main feature of Kantorovich's proposal was that the correct solution of any economic planning problem required the calculation of prices of inputs and outputs which, in effect, equated supply and demand. Prices that are generated by a linear programming model are referred to as "shadow prices." Kantorovich did not say that they had to be used in actual transactions but only in the calculation of the plan. Shadow prices

---

\* Oskar Lange in On the Economic Theory of Socialism, University of Minnesota Press, 1938, pp. 57-142.

\*\* For example -- to find the optimum routing of a given number of ships between several ports of call, the quantities of freight to be hauled between each pair of ports being given.

C-O-N-F-I-D-E-N-T-I-A-L

C-O-N-F-I-D-E-N-T-I-A-L

evoked vigorous controversy among economists. Some such as Nemchinov and Belkin supported Kantorovich, but more denounced him for adopting Western economic ideas. Whether or not they agreed with Kantorovich, almost all Soviet economists agreed and still agree that prices in the Soviet economy badly needed reform.

A separate stream of thought has been the general concern for the economic incentives of enterprise managers. The question of the index of performance on which managers' bonuses should be based has concerned political leaders, including Khrushchev, and enterprise managers as well as economists. General dissatisfaction with the Gross Value of Production as an index of enterprise performance led to revision of the system of bonuses in 1959. The 1959 system tied bonuses to cost reduction and several other indexes in a very complicated formula. The chief results of the bonus revision were to enflame the controversy and to lengthen the list of press complaints of bad industrial practices. In fact, there is recent evidence which suggests that the new system was never widely implemented.

In September 1962, Pravda unveiled the now famous proposal of Professor Ye. Liberman of Khar'khov to use profitability as the primary index of enterprise performance. According to Liberman, the state should confine itself to planning outputs for enterprises and should allow enterprises to decide on labor and capital inputs on the basis of profitability. Liberman noted that some prices might need to be adjusted (upward) to make sure that the products in question were produced. Shortly thereafter came the proposal of Professor Berg that industrial prices be drastically revised and made to cover full costs. Berg's proposal was essentially a revival of Kantorovich's, except that he did not mention Kantorovich or the principle of scarcity (supply and demand) in his public statement.\* Following Khrushchev's criticism of the industrial planning and performance at the recent plenum, economists Birman and Belkin wedded Liberman and Berg, advocating a revision of prices as a necessary condition for the success of Liberman's profitability

\* The distinction between full cost pricing and pricing by supply and demand is crucial to Marxists and in practice. Even if the price of a product covers the full cost, including capital charges, production either may exceed or may fall short of demand.

C-O-N-F-I-D-E-N-T-I-A-L

C-O-N-F-I-D-E-N-T-I-A-L

criterion. Like Berg, they, too, called for prices to be determined by full costs including capital cost, and like Berg, they agreed in principle with Kantorovich, while carefully avoiding any mention of his name.

Enterprise managers have worried less about prices and more about the confusion and lack of coordination in the enterprise output and supply plans. They have, in general, endorsed simplifications -- although not necessarily Liberman's -- which promised to reduce the quantity of supervision and petty tutelage over the enterprise.

The proposals as they stand are only the one step short of Lange's market socialism -- that is, that prices should be set so as to clear the market. In his favorable comment on Liberman's proposal, Nemchinov clearly advocated the use of price incentives by the state to guide production, raising the price of a good of which the state wants a greater supply. If the economists were to say that prices should be deliberately used to transmute the demands of buyers into the production patterns of the suppliers, they would have taken the last step.

Soviet economists are familiar with Western economics and with Lange's writing. The Soviet press is filled with complaints by buyers against suppliers. One cannot avoid the conclusion that supply-demand pricing would be the next objective of the "liberal" economists, if the present proposals were adopted. This small logical step, however, would be an enormous ideological one. These economists would be proposing, in effect, to substitute for central planning of enterprise outputs Adam Smith's "invisible hand."

### III. Khrushchev and Economic Administration

Nikita Sergeyevich Khrushchev is a shrewd Russian peasant who evokes God, believes in Communism and common sense, and probably sees no inconsistency between the two concepts. The niceties of ideological theory mean little to him, but the Communist party and its historic mission means everything to him. He has been a party activist all of his adult life. He has no use for impersonal logic and abstractions. His personal experience is his guide. He knows what and whom he has seen, touched, talked to, and worked with. He sees economy-wide problems as simple multiples of

- 4 -

C-O-N-F-I-D-E-N-T-I-A-L

C-O-N-F-I-D-E-N-T-I-A-L

problems that he personally solved in this mine or that farm in the Ukraine many years ago.

Khrushchev's model for economic problem solving is as follows.\* The party man (Khrushchev) sees the problem (output must be raised). He goes directly to the worker, explains the goal and its importance, and wins his confidence and enthusiasm. The worker then reveals a secret trick that he has to double output -- a trick which he will adopt provided that certain government bureaucrats leave him alone. The Party man chases away the bureaucrats, and the problem is solved. All of Khrushchev's reorganizations in both industry and agriculture have been merely generalizations of this model. He sees administration as a kind of continuous trouble shooting. He has steadily reduced or eliminated government bureaucracies -- the industrial ministries, the Ministry of Agriculture, the machine tractor stations -- and replaced them with Party organs or lower level government agencies under the supervision of Party organs.

The most conspicuous feature of Khrushchev's administrative approach is his violent opposition to bureaucrats and bureaucracy. Beginning with his attacks on the ministries in 1957 and continuing to the chastisement of Gosplan in November 1962, bureaucratic rigidities, compartmentalization, and red tape have been the villains of the long drama. The hero of the drama, of course, is Khrushchev, the inspired Party man who sees the goal; discovers a means; and acts immediately, disregarding procedures, channels, jurisdictions, and vested interests.

This procedure does not mean the replacement of a government bureaucracy by a Party bureaucracy. The essence of a bureaucracy (which is to say, any administration) is the performance of specified routine functions by a hierarchy of authority, each level operating under a clear and unduplicating set of rules and responsibilities. A bureaucrat is a functionary; a Party man is an aktivist. The good bureaucrat fulfills his assigned function faithfully according to the rules. The good Party man

---

\* This course of action is simply a paraphrase of the anecdote that Khrushchev related in his speech to the plenum of the Party Central Committee on 19 November.

C-O-N-F-I-D-E-N-T-I-A-L

C-O-N-F-I-D-E-N-T-I-A-L

achieves an overriding goal, assigned or not, regardless of rules. This concept is "Aktivnost'!" Khrushchev is profoundly anti-rule.

Controversy has raged in the West as to whether the industrial and agriculture reorganizations of 1957 and 1958 were decentralizations. Clearly formal responsibilities were assigned to units at lower levels in each case. But, equally clearly, arbitrary intervention from higher levels increased simultaneously. The formal decentralization was offset by informal centralization. The significant change was from bureaucratic formality to Party informality. Party control has meant no clear lines of authority, but intervention in the affairs of enterprises and kolkhozes by any number of uncoordinated authorities at local, oblast, republic, or all-union levels.

The latest reorganization has carried these trends even further. The systematic but uninspired ministrations of Gosplan are to be replaced in part by state committees for various branches of industry and by industry and agriculture bureaus in the Central Party Committee. Party committees at the oblast level will be the direct supervisors over enterprises and farms. The general instruction to all is to innovate, introduce new technology, uncover hidden reserves, and not to stand on ceremony or rules. What is left of the old Gosplan, the new all-union Sovnarkhoz, has the unenviable job of trying to coordinate all of these concepts without being a bottleneck.

#### IV. Khrushchev and the Economists

The arguments of the two preceding sections clarify the positive positions of Khrushchev and the economists. They are against the same thing -- rigid bureaucratic administration of the economy. But what they are for could not be more different. The economists would replace bureaucratic rules by the impersonal rules of profit maximization, prices set by full cost (or supply and demand), and planning by mathematically programmed electronic computers. Khrushchev wishes party supervision of the economy to be bound by no rules whatsoever.

The two processes are mutually incompatible in practice. That does not mean that both cannot be formally adopted -- only that both cannot

- 6 -

C-O-N-F-I-D-E-N-T-I-A-L



C-O-N-F-I-D-E-N-T-I-A-L

operate simultaneously. Khrushchev will have his reorganization, and some parts of the economists' proposals also may be adopted. But there is small chance that the Party activists would accept the operation and results of profit maximization as being in the "best interest of the state." Profit maximization would on occasion call for reducing output, for turning down the delivery of a machine if it had defects, for refusing to install a new technology if it was dubious or unproved, or for reducing output of a high priority commodity in favor of a low priority one. The liberal economists would say that each of these developments could and should be corrected by adjusting some price. The Party activist, out of patience, would denounce the enterprise managers in question for commercialism, and operation would be restored to the condition intuitively known by the Party man to be "good." In short, the effect of a profit-maximizing rule would be nil, just as the effect of the cost reduction rule in 1959 was nil.

#### V. Rules Versus Authority

Khrushchev in many ways is a representative Party man. His views on Party authority would be those of most Party members. In the simplest sense the issue is the contradiction between impersonal rules and personal authority that besets any government. We can be sure that, like Khrushchev, the Party would prefer to maintain its own unrestricted authority.

Nevertheless, the economic pressure for better management of resources is more likely to grow than to diminish. The recent evidence indicates that the return on investment in the Soviet economy is declining. This situation has come about partly as a penalty of success. The level of technology of new plant and equipment generally exceeds the average level of technology in use. The rapid growth of the Soviet economy has been due to the large gap between the low level of technology in use and the high level available for borrowing from the West. As a result of 15 years of massive investment in the postwar period, the gap has narrowed. Gains from new technology are not coming as easily as before. In consequence, gains from organizational change appear to be relatively more attractive than before.

- 7 -

C-O-N-F-I-D-E-N-T-I-A-L

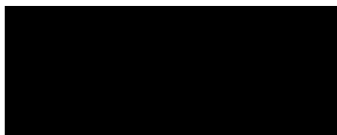
C-O-N-F-I-D-E-N-T-I-A-L

If, as it now appears, Party troubleshooting should prove to be an inadequate answer to increasingly subtle economic problems, some successor of Khrushchev may decide that the interests of the authority of the Party as a whole are better served by limiting through stricter rules the authority of lower Party levels. There appear to be only two choices in rules for economic administration: (1) a systematic administrative hierarchy with appropriate definitions of mission and function or (2) the rules of the market place, with profit maximization and prices equating supply and demand. These two possible directions of evolution are an interesting dilemma for the Party of the October Revolution -- bureaucratization or creeping capitalism.

C-O-N-F-I-D-E-N-T-I-A-L

C-O-N-F-I-D-E-N-T-I-A-L

Analyst:



25X1A

Coord:

- 9 -

C-O-N-F-I-D-E-N-T-I-A-L

Approved For Release 2000/06/07 : CIA-RDP79T01003A001500080002-5  
**CONFIDENTIAL**

**CONFIDENTIAL**

Approved For Release 2000/06/07 : CIA-RDP79T01003A001500080002-5